# The Fixed Price Offering System

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SECURITIES INDUSTRY ASSOCIATION

# INTRODUCTION

From 1974 through 1978, American corporations raised $168 billion in underwritten public offerings. Firm commitment underwritings utilizing "fixed price offerings" accounted for the lion's share of these funds. Thus, the fixed price offering system has played a central part in the process by which American corporations have raised urgently needed equity and debt capital from public investors.

Nonetheless, as a result of events now unfolding at the Securities and Exchange Commission ("SEC"), the fixed price offering system could be seriously damaged or destroyed. The Securities Industry Association ("SIA") believes that its members and the public at large should be aware of these developments and of the possibility of harm to a key part of the nation's capital formation mechanism.

Following this introduction are comments recently submitted by the SIA in connection with the SEC's consideration of certain rule proposals of the National Association of Securities Dealers, Inc. ("NASD") which are intended to prevent an erosion of the fixed price offering system. An awareness of earlier events and circumstances will aid readers in their understanding of these comments and of the threat that currently overhangs the fixed price offering system.

The narrative begins with the decision of the United States District Court in New York in *Papilsky* v. *Berndt* (1976). In that case, the directors of Affiliated Fund were held liable for their failure to give appropriate consideration to the possibility of interposing Lord Abbett, the fund's investment adviser and an NASD member, as an underwriter or selling group member in offerings of new issues which the fund had decided to purchase. The court reasoned that the discounts or concessions obtained by Lord Abbett could be applied to reduce the management fee payable by Affiliated Fund. The court's conclusion rested in part on its understanding that no rule of the SEC or NASD prohibited this form of "recapture."

Some months later, in response to letters from Lord Abbett and several other mutual funds, the NASD advised that Article III, Section 24 of its Rules of Fair Practice did in fact prohibit members from engaging in the practice described in *Papilsky*. By way of explanation the NASD said:

> "...the net effect of permitting Affiliated to recapture underwriting concessions would be to authorize it to purchase securities in a distribution at prices not available to the general public. To permit such would unfairly and improperly discriminate against customers generally; in particular, small investors. To state it differently, such would create a special or select customer, or group of customers. In this case, it would be Affiliated, but more broadly it could be *all* institutions."

Shortly thereafter the SEC wrote to the NASD questioning its "interpretation" of Section 24 and requesting that the interpretation be filed "as a proposed rule change for thorough consideration in accordance with the procedures specified" in the Securities Exchange Act for disapproving proposed self-regulatory rules. The NASD countered that its letters constituted nothing more than restatements of Section 24 as written and were not in any sense a proposed rule change. The NASD requested an opportunity to confer with the SEC before proceeding further.

In May 1977 a public conference was held. The NASD reiterated its belief that it had said nothing new about Section 24 or its meaning. During the colloquy several Commissioners questioned whether certain underwriting practices—specifically mentioned were swaps and the use of selling concessions to pay for research—were inconsistent with Section 24 and with the concept of a fixed price offering. The NASD replied that it was prepared to examine these practices and, if necessary, to come forward with new rules or interpretations to eliminate any inconsistencies.

A special NASD committee studied the situation and produced a set of rule proposals—generally known as the "Papilsky rules"—which were approved by the membership and submitted to the SEC in midsummer 1978. The NASD's proposed rules contain the following key features:

- They redefine and tighten the parameters beyond which swap transactions become prohibited "overtrades."
- They provide that selling concessions, underwriting discounts or allowances may not be used to compensate members for research or other products or services which are commercially available or are provided by the member for cash or some other agreed upon consideration ("soft dollar" payments).
- They prohibit sales by underwriters to certain related persons.

The SEC published the NASD's rule package for public comment in August 1978. Despite an extension of the initial filing date, relatively few comments were submitted although the soft dollar payment prohibition drew sharp criticism from a number of institutional investor and industry commentators who contended that this practice is a normal and legitimate means of fulfilling research obligations.

In February 1979 the Antitrust Division of the Department of Justice filed comments with the SEC in which it suggested that the practices addressed by the NASD rule proposals were evidence of healthy competition among underwriters which should not be suppressed. Further, the Department of Justice stated that, "The existence of 'rebates,' especially if they are widespread, may also suggest that the fixed price system for distributing new issues, though familiar, is in fact not workable," and it urged the SEC to "explore the fundamental issue—whether the method of selling new issues pursuant to fixed price offerings is so necessary or appropriate as to justify imposing it by regulation upon underwriters and the investing public."

The SIA responded that the Department of Justice failed to appreciate the vital part that the syndicate system and limited price maintenance play in this nation's capital-raising process. The SIA further urged that if Washington should harbor the belief that there is a *better* system, then the Executive Branch, including the Departments of Treasury and Commerce, as well as the Department of Justice and the SEC, should undertake a real study of our capital-raising process and its alternatives before abruptly dismantling the present system.

It is against this background that the SEC, in May 1979, issued the release which is the subject of the SIA submission reproduced in this booklet. That release, some 60 pages in length, solicited further comment on the NASD's Papilsky rules. Among other things, the release asked numerous questions about current underwriting practices and about the potential effects of the proposed rules upon the distribution of securities and upon investors and underwriters. The release also probed the issue of the NASD's authority under the Securities Exchange Act to adopt such rules and its ability adequately to enforce them.

For the reasons stated in our comment, the SIA believes that preservation of the fixed price offering system is essential to the maintenance of a mechanism which over the years has assisted corporations, large and small, seasoned and speculative, to raise capital at reasonable cost from a broad spectrum of individuals and institutions. To jeopardize this key element of the capital formation system would, in our opinion, be contrary to the nation's interest.

**Securities Industry Association**

**August 1979**

# COMMENTS OF THE SECURITIES INDUSTRY ASSOCIATION IN RESPONSE TO SEC RELEASE NO. 34-15807 ("PRACTICES IN FIXED PRICE OFFERINGS")

In Release No. 34-15807 (the "Release"), the Commission has solicited data, views and arguments concerning fixed price offerings and the NASD's proposed rule changes relating to fixed price offerings.

By means of discrete underwriting syndicates the nation's broker-dealers join forces in fixed price offerings to raise billions of dollars of capital each year for corporate issuers by purchasing their securities and selling them to the public. The use of limited price maintenance by underwriting syndicates is essential to the distribution of such securities to the public at the lowest possible cost to issuers. Since the Commission's decision in **In re National Association of Securities Dealers, Inc.,** 19 S.E.C. 424 (1945) (the **"PSI** case"), there have been substantial changes which are subjecting underwriting syndicates and the fixed price offering system itself to increased pressures.

The Securities Industry Association is concerned that, absent some NASD rules in this area, the fixed price offering system will suffer an erosion which will lead to higher costs to issuers of raising capital, a reluctance by underwriters to underwrite securities of newer or smaller issuers, the elimination of individual investors from the market for new securities and a reduction in the number of broker-dealers engaged in underwriting. Accordingly, the Securities Industry Association supports adoption by the NASD of rules designed to prevent erosion of the fixed price offering system.

In responding to the Commission's Release, we shall comment on the underwriting process generally, practices which are the subject of the NASD's proposed rule changes, the adequacy of current disclosures with respect to these practices, the authority of the NASD to adopt the proposed rule changes and the policy considerations which we believe are of vital importance in determining whether the proposed rule changes should be approved or disapproved.

## The Underwriting Process and Certain Sales Practices

In the Release the Commission describes in general terms the underwriting process and certain selling practices, requests comments on the description and asks certain questions with respect to the process and the selling practices. While the Commission's description is accurate enough as far as it goes, it requires some elaboration.

**Generally.** We should like to emphasize that syndicates and their price maintenance arrangements are limited-purpose, short-lived arrangements among a limited group of underwriters. They are designed to introduce into the marketplace a relatively large supply of additional securities at the best possible price to the issuer and with a minimum disruption of the marketplace. In doing so, syndicates are selling in competition with existing supplies of securities of the same issuer, comparable securities of other issuers and other savings and investment instruments. In the case of non-convertible debt securities and preferred stocks and common stocks which trade on a yield basis, syndicates are attempting to sell securities which compete with all other securities which trade on yield basis. In the not unusual situation in which a syndicate is unable to sell all of an issue at the fixed offering price, the managing underwriter terminates the price restrictions and permits underwriters and dealers to sell the securities at whatever price they can. Whether the distribution has been successful or unsuccessful, these joint marketing arrangements last from as little as a few hours to as long as two weeks, rarely longer.

Spreads are the prices charged to issuers for underwriters' services in distributing securities, and price and spread are set competitively in the marketplace on a distribution-by-distribution basis. Investment banking firms compete fiercely for managership and co-managership of new-issue business, and they compete for business via price and spread. In competitive bids, each competing group bids price to the issuer in the light of that group's ideas about gross spread and price to the public. In negotiated offerings, the price to the issuer, the spread to the underwriters and the offering price to the public are negotiated by the issuer and the managing underwriter in relation to the terms negotiated by other issuers with other managing underwriters in comparable offerings. When underwriters expect that a substantial portion of the offerings will be placed with institutions purchasing in large quantities, experience shows that the economies of scale realized through sales of large quantities to a limited number of customers are frequently

reflected in a reduced spread on all the securities being sold.

These facts are very important to bear in mind because they demonstrate the fundamental difference between fixed price offerings and fixed commission rates. In fixed price offerings, spreads are set issue by issue and reflect market factors, including competition for issuers' business. Fixed commission rates were industry-wide rates established for all listed securities for an indefinite time notwithstanding changes in market conditions.

**Swaps.** There are significant differences which affect the incidence of swaps* in fixed price offerings.

First and most important is the difference between debt and equity securities. It is inappropriate to extrapolate from practices found primarily in distributions of certain debt securities to distributions of all securities.

While there is little hard information about the extent of swapping, discussions with syndicate departments suggest that swapping is more prevalent in debt issues, especially "Yankee" bonds, "high-yield" bonds and debt securities of issuers which frequently come to market, **e.g.**, telephone companies and electric and gas utilities. In equity offerings, swapping seems to be limited to utility preferred stocks and utility common stocks. Generally these are all securities which sell on a yield basis, are aggressively priced as a result of competition among prospective managing underwriters, are in oversupply and, as a result, are harder to sell. It also seems that swaps are more common in competitive bids than in negotiated underwritings. This is due not only to the fact that most competitive bids involve utility securities but also to the need of the winning bidders, which as a practical matter have not been in a position to solicit pre-bid indications of interest, to reduce their underwriting exposure as quickly as possible.

Second, swapping appears to be limited to certain classes of sellers and buyers. Only underwriters with a substantial secondary market trading capability can engage in swaps to any appreciable extent. Usually the other side of the transaction is an institutional buyer with a substantial securities portfolio which is short-term performance oriented and which buys and sells securities in large quantities. In many cases, the institution engages in a swap because it finds it necessary to sell one security in order to obtain the funds needed to purchase another. In other cases a salesman with knowledge of the institution's portfolio may suggest a swap in order to improve the quality or the yield of the portfolio.

A swap transaction is not a barter transaction. Each side of the swap is settled by the payment of cash. The sale of the offered security and the purchase of securities from the institution may not be concurrent, and the settlement dates may be several days apart.

The advantage of the swap to the institution may be more apparent than real. With the underwriter's secondary trading capability and familiarity with the market, the underwriter is in a better position to know what it can do with the purchased securities than the institution which sells them.

Whether the swap gives rise to an economic loss to an underwriter willing to accept it in order to encourage an institution to buy the security being distributed will depend on the price at which the underwriter is able to resell the security purchased from the institution. Depending on the time between purchase and resale, this price may be affected by intervening changes in the securities markets.

Underwriters engage in swaps in order to diversify their risk by substituting other securities for the securities in process of distribution and to provide an institutional investor with the funds needed to purchase the securities being distributed.

Under current record-keeping requirements, it would be very difficult to determine the amount of securities sold as a result of swap transactions, either in the case of a particular securities distribution or by general classes of securities distributions. In many situations, it would be impossible to determine, even on a transaction-by-transaction basis, whether and to what extent swaps result in losses to an underwriter willing to engage therein in order to dispose of underwritten securities.

**Designated Sales.** The Release does not adequately reflect the role of designated sales* in the underwriting process. Designated sales relate to only a portion of the securities in the "pot," which are the securities not released by the managing underwriter to the other underwriters for their direct sales. There are several reasons, having nothing to do with designated sales, for the creation of a "pot".

Prior to pricing an issue the existence of the "pot" enables the managing underwriter to identify major institutional buyers and test the appetite and price ideas of potential customers. The "pot" is also an aid to the managing underwriter in monitoring the status of the syndicate effort. A managing underwriter can learn much as it advises a participating underwriter of a designated order. Whether the participating underwriter elects to cover the order from securities released or to be released to it for sale or seeks to have it covered from the "pot" will be a good indicator of the

** In using the term "swap", we mean the purchase of a security by a broker-dealer from a customer pursuant to an agreement or understanding that the customer purchase from the broker-dealer securities which are part of a fixed price offering—whether or not the purchase is within the parameter proposed by the NASD.*

** A designated sale is a sale, usually of a large amount of securities, to an institution by a managing underwriter for the account of one or more syndicate or selling group members designated by the institution.*

state of its own sales effort or its expectations as to what it should be able to sell in addition to the designated order. The reactions of a number of participating underwriters will give the managing underwriter a good idea as to the status of the offering.

The allocation and reallocation of securities to various potential customers on an indication-of-interest basis are a vital part of the pricing mechanism used to achieve a balance between a fair price for the issuer and the price to be paid by interested buyers. Inherent in the process is the allocation of as much as possible of the issue to buyers who have indicated interest at the highest price. To do this the managing underwriter needs to identify as many orders and price indications as possible. The knowledge of "pot" sales which are to be made by the manager and of the designated orders and the manner in which they are to be covered furnish the managing underwriter with a great deal of information essential to this allocation process.

The managing underwriter's objective is to place a substantial portion of the securities with institutions which are long-term investors rather than institutions which are interested in speculation. The existence of a "pot" assists the managing underwriter in selling the desired quantity of securities to such investors. In many instances, if these quantities are not available to such investors, they will refrain from buying any of the issue.

The "pot" provides institutions with the convenience of centralizing billing and delivery. Indeed, institutions often request centralized billing and delivery even when they are purchasing from a number of dealers and not from the "pot".

An institution will frequently designate underwriters or dealers for reasons other than payment of specific soft-dollar obligations for products or services furnished. Broker-dealers furnish research, show private placement opportunities and investment ideas, provide execution services and furnish other services in order to attract the institutions' business, not only in the new issue market, but generally. Even when these promotional activities are not aimed at inducing institutions to purchase a particular new issue, they are supportive of the securities distribution process in a general way. For example, the report of a portfolio performance evaluation service may suggest to an institution that is should dispose of some investments and acquire newly issued securities. Once an institition has decided to purchase securities, it will usually attempt to obtain some mileage out of the purchase by insisting that the managing underwriter give credit for the sale to specified underwriters or dealers rather than treat the sale as one for group account in proportion to underwriting commitments. Or an institution which has succeeded in obtaining securities directly from certain participants in the distribution may designate them with respect to additional securities obtained from the managing underwriter.

It is possible with respect to specific securities distributions to determine institutional purchases which are credited to multiple underwriters' and dealers' accounts. And, in general it can be said that with the growth in institutional purchases of new securities issues, the relative importance of designated sales has increased. It may be difficult, however, to determine the portion of such sales attributable to satisfaction of soft-dollar obligations as opposed to centralized billing and delivery, normal business relationships, etc. or to determine the extent of the satisfaction of soft-dollar obligations.

## Adequacy of Disclosure

The threshold question is: Do particular swaps, designated sales, etc. in fact operate as effective discounts from the public offering price and, if so, how do you measure the amount of any such discount? Is there a discount if an underwriter buys a security in a swap and resells it at cost or at cost plus a normal profit or agency commission? What effect is to be given to market changes between purchase and resale? What if an underwriter incurs a loss on the resale of a particular security purchased in a swap but not in the aggregate on all securities purchased in swaps either in a particular offering or over a given period in all offerings? What if one underwriter in a syndicate incurs a loss on a security purchased in a swap from a particular institution but all underwriters in the syndicate make a net profit on all securities purchased from institutions in swaps? To what extent are designated sales the result of informal business relationships in which a broker-dealer provides a variety of services to an institution in the hope of receiving business in return?

Swaps and designated sales have been involved in the distribution of securities for many years as is well known to institutional investors. It is unlikely that individual investors would care about them or that knowledge that they exist to the extent they presently do in some situations would be likely to affect investors' investment decisions.

These practices may or may not occur in a particular offering and may arise only after effectiveness of the registration statement as a result of the reception of the offering in the marketplace. Neither the managing underwriter nor the issuer will know in advance whether or to what extent the practices will occur. Accordingly, it is extremely difficult, if not impossible, to know when to state that such practices will take place, and the statement that they may or may not occur does not appear to be informative or helpful to prospective investors.

While it would, of course, be possible to describe such practices in general terms, we doubt that it is possible to be specific or particularly informative. And we question what good, if any, this very general

disclosure does a potential investor.

Finally, we would point out that disclosure does not improve the position of the smaller investor. As a practical matter, his portfolio and proposed purchase are of such size that he is in no position to engage in meaningful swaps or designated sales. Accordingly, we believe that limitation of the selling practices in question, as in the NASD's proposed rule changes, is a more effective way of benefitting investors than disclosure.

## Authority of the NASD

**General.** Limited price maintenance by underwriting syndicates has long been the pillar of the American securities distribution process, the most successful capital-raising process in the world. In recent years certain segments of that system have been threatened by an erosion which could seriously damage the system.

Because of technological advances in the clearance and settlement system, managing underwriters are no longer in a position to detect violations of their agreements among underwriters. And it is uneconomic and ineffective to pursue remedies against violators in the courts. By the time a court could render a decision, the securities distribution in question would be ancient history. The cost would certainly be high, and the damages would be uncertain and difficult to prove. It is unrealistic to expect the few originating firms to take on such a burden in order to support the system.

It is the damage to the capital-raising system that continuing erosion can cause that is the chief reason for concern. It is an industry and even national problem and not that of a particular issuer, underwriter or a group of underwriters. Accordingly, NASD surveillance as part of its on-site examinations is the only economic and practical way to see to it that NASD members act in accordance with their agreements with each other.* Absent some NASD rules in this area, it is feared that the fixed price offering system will suffer an erosion which would lead to higher capital-raising costs to issuers and a reluctance by investment bankers to underwrite securities of smaller, riskier issuers.

Changes Since PSI. The Commission asks whether there have been any changes in the securities industry since its **PSI** decision which might affect the economic justification for fixed price offerings. We believe that there have been many changes since 1945 which make underwriting riskier and subject underwriters and dealers to greater pressure to grant special treatment to institutional investors. We believe that, as a consequence of these changes, NASD rules are necessary to buttress and preserve the fixed price offering system as an effective means of raising capital from the public.

The amount of capital being raised for corporations through underwriting syndicates utilizing fixed price offerings has increased dramatically. See Appendix A. The number of firms engaged in the distribution of securities has declined, in part as a result of insolvencies and in part as a result of consolidation in the industry. See Appendix B. Markets have become more visible and more volatile. Changes in fiscal and monetary policies and developments affecting the nation and the issuer seem to have a more immediate and greater impact in the marketplace. There is increased uncertainty as to the future economic environment. All these developments contribute to a general increase in underwriting risk and a greater need for the fixed price offering system.

Institutional investors have become more powerful, more sophisticated and more short-term performance oriented. The market value of common stock owned and/or controlled by institutional investors increased from $237 billion in 1967 to $341.5 billion in 1977.* Institutional ownership of shares listed on the New York Stock Exchange increased from 25% in 1969 to 34% by 1975.** And institutions' share of the volume and value of shares traded on the New York Stock Exchange soared from 33% and 39%, respectively, in 1961 to over 57% and 70%, respectively, by 1976.*** Institutions with their greatly enhanced buying power and participation in the securities markets are placing greater and greater pressure on underwriters to obtain special treatment in securities distributions. As a result of this increased power of institutions, NASD rules buttressing the fixed price offering system are needed now more than ever.

Underwriting has become even more competitive.**** Investment banking firms are competing more intensively for the managership and comanagership of underwritings. In order to do so more effectively and to minimize reliance on underwriting profits, firms have broadened the range of services they offer to investment banking clients and potential clients. This has led a number of the major firms to enter or increase their presence in areas such as cor-

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* *Both the Commission and the courts have upheld the NASD's authority to discipline a member for violation of an agreement with another member when the violation involves bad faith and thus violates the standards required by Article III, Section I, of the Rules of Fair Practice.* ***Nassau Securities Serv. v. SEC,*** *348 F. 2d 133 (2d Cir. 1965);* ***Buchman v. SEC,*** *553 F. 2d 816, 820-21 (2d Cir. 1977) (dictum);* ***In the Matter of B. Werner,*** *44 S.E.C. 622 (1971);* ***In the Matter of Mutual Funds Serv. of Florida, Inc.,*** *42 S.E.C. 1035 (1966);* ***In the Matter of M.S. Wien & Co., Inc.,*** *42 S.E.C. 894 (1966). A fortiori the NASD should have the authority to discipline a member for violating more specific rules relating to certain abuses in securities distributions even though the violation also involves a breach by a member of an agreement with other members.*

* *SEC,* ***Statistical Bulletin*** *9-10 (June 1978).*

** *NYSE,* ***Fact Book*** *50 (1979).*

*** *NYSE,* ***Public Transactions Study*** *10 (1976).*

**** *See Hayes, "The Transformation of Investment Banking,"* ***Harv. Bus. Rev.*** *153 (Jan.-Feb. 1979).*

porate bond trading, equity trading, research, mergers and acquisitions, project finance, international finance, public finance and real estate. Many firms have created "new business departments" designed to seek out investment banking clients, and many firms have added substantially to their corporate finance staffs. See Appendix C. With these increased staffs, originating firms are calling on their own clients more often, are making more "new business calls" on others' clients and are scouring the country seeking to establish new investment banking relationships. Investment banking firms are putting out research reports and investment recommendations on their existing and potential investment banking clients, making markets in their securities and providing a wide range of corporate finance advice and services at little or no charge in an attempt to establish and maintain investment banking relationships.

This competition culminates in attempting to obtain for issuers the highest possible net proceeds. Thus, particularly in the case of utilities, it has become common for a managing underwriter to set the public offering price for common stock as much as 3/8 over the last sale price, a practice called "plussing".* And, in the case of debt issues, it is now common to price an issue not on the basis of the current market but on the basis of any anticipated improvement in the market.

Investment banking firms use the annual published rankings in volume of corporate securities issues managed or co-managed as a record of their achievement and as a selling tool in acquiring new business. Certain securities firms which 10 to 20 years ago were not significant factors in underwriting have devoted substantial time, effort, talent and money to building up their underwriting departments and have succeeded in acquiring substantial shares of the corporate underwriting business, measured both in terms of volume of issues managed or co-managed and in terms of volume of securities actually distributed. See Appendix D. In particular, firms with substantial retail distribution or secondary market-making capability have been able to use this to improve their underwriting position, obtain co-managerships and managerships and obtain more merchandise for sale by their retail systems.

At the same time the direct costs to underwriters and dealers of engaging in the underwriting business are increasing. Salaries of professional and clerical staff and the cost of travel, communications, printing, advertising and legal, accounting and consulting services have all increased. Selling concessions as a percentage of spread (see Appendix E) and salesmen's commissions as a percentage of the selling concession have generally and substantially increased. The net result is that the profitability of underwriting as such and perhaps of distribution as well has been adversely affected.

Issuers have become more sophisticated in their use of investment bankers. Many are insisting on the addition of co-managers. Many are changing managing underwriters from time to time or using a number of investment bankers for various specialized purposes. Moreover, spreads on corporate underwritings are a matter of public record. Managing underwriters collect data on all corporate underwritings and, in negotiating spreads with issuers, routinely provide them with "spread sheets" showing the spreads on all recent comparable issues. Even if they did not, issuers could obtain such information from another investment banking firm acting in a consulting capacity or from financial publications.

A number of developments evidence issuers' increasing sophistication in the use of investment bankers. Various issuers are experimenting with different ways of distributing securities to the public which differ from the traditional underwritten public offering. Ford Motor Credit Corp. and General Motors Acceptance Corp. have sold short- and medium-term notes on a continuing basis both directly and through brokers. Bank of America is selling mortgage pass-through certificates in much the same way. Citicorp is selling commercial paper at simple auction and has recently registered $1 billion of notes of various maturities for direct sale to investors. Exxon Corp. has conducted two Dutch auctions of pollution control revenue bonds. Furthermore, through an increasing number of shareholder dividend reinvestment and stock purchase plans, sponsoring corporations are able to obtain, without any investment banker participation, substantial amounts of capital.* However, for most corporate issuers, none of these will replace the traditional underwriting as the principal means of raising capital from the public.

In addition, issuers have other means of raising capital which compete with underwritings. Issuers have increasingly met their short-term capital requirements through revolving bank credit agreements, sales of commercial paper and sales of relatively short-term notes through dealers on a private placement basis. Issuers have been resorting to banks, both domestic and foreign, for longer term loans, some for periods as long as seven to ten years, occasionally at fixed interest rates. And, perhaps most importantly, issuers have been raising increasing amounts of long-term capital through direct private placements with institutions. The amount of capital raised by corporations through direct private placements has increased from $12.2 billion in 1973 to $25.7 billion in 1977 and

* *Underwriters are able to do this because purchasers in the secondary markets would have to pay a commission as well as the actual purchase price of the security.*

* *During 1978 dividend reinvestment plans provided corporations with new equity capital totaling about $1.2 billion. Salomon, "Dividend Reinvestment—A New Force in Equity Financing",* ***Investment Dealers' Digest*** *43, 44 (May 1, 1979).*

$23.5 billion in 1978.* Indeed, some of the larger insurance companies have begun calling on issuers directly with a view to initiating private placements and one or two have even established regional presences for this purpose. While the terms of the securities in these placements are often more restrictive than the terms of publicly offered securities, the cost of money to the issuer is frequently competitive with that of a publicly offered security. Moreover, commercial banks are beginning to compete with investment bankers for the business of arranging direct placements and a number of issuers arrange their own direct placements without the intervention of investment or commercial bankers. And, finally, there are venture capital firms, and some institutions have formed venture capital affiliates, which make equity investments in "emerging" companies.

The increased competition, both from other investment bankers and from other methods of raising capital, with the concomitant result of more aggressive pricing, makes underwriters more vulnerable to pressures from institutional purchasers to be accorded special treatment.

Underwriters and dealers have believed for decades that the NASD's Rules of Fair Practice as well as underwriters' agreements have prevented underwriters in fixed price offerings from giving discounts from the public offering price except to broker-dealers which actually perform services in the distribution. We are concerned that if the Commission disapproves the NASD's proposals in their entirety and suggests that the existing rules do not prevent discounts, this will unleash irresistible pressures by institutions for discounts which could lead to a breakdown of the fixed price offering system itself, with serious consequences to the nation's capital-raising process.

**Exchange Act Standards.** The Commission asks whether the proposed rule changes would "fix minimum profits or impose [a] schedule or fix rates of commissions, allowances, discounts or other fees" in contravention of Section 15A(b)(6) of the Exchange Act. The only NASD rule relating to size of spreads is the NASD Interpretation with Respect to Corporate Financing, which limits **maximum** spreads on certain types of securities distributions. The proposed rule changes do not "fix minimum profits" or "impose [a] schedule or fix rates of commissions, etc.". They say nothing about what spreads should be, either with respect to security distributions generally or with respect to any class of securities distribution. The proposed rule changes merely say that during the period of a particular distribution, **i.e.,** until price restrictions are terminated (which may take place anytime from a few hours to two weeks, rarely more, after effectiveness), the underwriters must not attempt to evade directly or indirectly their agreements to sell at the stated public offering price the securities being distributed. By no reasonable reading of the statutory language are these rules which fix minimum profits or rates of commission.*

The Commission asks whether the proposed rule changes would create impediments to a free and open market in contravention of Section 15A(b)(6) of the Exchange Act or have any anticompetitive effects in contravention of Section 15A(b)(9) of the Exchange Act. We believe that the free and open market referred to is not the market for a particular security during the limited period of its distribution but rather the nation's securities markets generally.* Syndicates are temporary, short-lived joint ventures designed to create a market for new securities issues or additional quantities of already traded securities. They promote rather than restrain trade. They add to rather than subtract from securities markets. The price maintenance provisions of agreements among underwriters and the proposed rule changes enable them to do this quickly and efficiently at the lowest possible cost to issuers and with the least possible adverse impact on the prices of securities already being traded in the securities markets.

**Enforceability.** The NASD has said that they believe that they can enforce the proposed rule changes. Based on their long experience in monitoring compliance with rules, we believe that their opinion is entitled to great weight. If actual practice shows that there are difficulties in enforcing the rules as proposed, then the rules should be revised to deal with the problems.

The Commission seems to imply in the Release that the proposed rule changes should not be approved unless there is reasonable assurance of 100% compliance or that every violation can and will be detected. Strictly speaking, no law or rule is enforceable if

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* ***Investment Dealers' Digest, Directory of Private Placements*** *p.4 (Apr. 3, 1979).*

* *In 1945 the predecessor of Section 15A(b)(6) provided that NASD rules may not be designed "to fix minimum profits,* ***to impose any schedule of prices,*** *or to impose any schedule or fix minimum rates of commissions, allowances, discounts or other charges." (Emphasis added.) In the* ***PSI*** *case the Commission premised its decision on the conclusion that "the PSI syndicate agreements contained a schedule of prices and discounts."* ***PSI*** *at 437. We believe that the legislative history of Section 15A(b)(6) and its predecessor, especially its amendment in 1975 to delete the reference to "schedule of prices" and to conform it to the similar restriction imposed on national securities exchanges by Section 6(e), indicates that Section 15A(b)(6) is aimed at broad, industry-wide fixing of commissions and other fees and not at particular syndicate agreements.*

* *See H.R. Rep. No. 2307, 75th Cong., 3d. Sess. 4, 8 (1938); S. Rep. No. 1455, 75th Cong., 3d. Sess. 3,7 (1938).*

everyone subject to the law or rule violates it. But at least until it is demonstrated that violation will be widespread and flagrant, possible difficulties of enforcement in some circumstances are not an adequate reason for not having a law or rule.

By and large the nation's citizens are law-abiding. Thus, even though there are not and never will be enough State troopers and police to catch and punish all speeders, speed limits and the fact that the nation's highways are patrolled are enough to keep most people driving at or near the speed limit. And certainly no one would seriously suggest abolishing all speed limits because it is impossible to catch and punish all speeders.

Similarly, the nation's broker-dealers are by and large law-abiding. Indeed, we believe that most are already living within the NASD's proposed rules relating to swaps and sales to affiliates. The facts that under the proposed rule changes they would have to keep records and the NASD would monitor compliance should be enough to ensure substantial compliance with such rules, notwithstanding the enforcement problems one can dream up in particular circumstances.

## Analysis of Policy Considerations

At the outset, we believe it is important to draw a distinction between overtrades and sales to affiliates on the one hand and designated sales on the other. We believe that overtrades and sales to affiliates represent a more direct and serious threat to the fixed price offering system than designated sales. While swaps and sales to affiliates have not on the whole been the subject of great abuse and, since promulgation by the NASD of the proposed rule changes, broker-dealers have made a good faith effort to live within the rules, release of broker-dealers from these limitations could lead to a serious erosion of the fixed price offering system. On the other hand, designated sales have long been part of the underwritten distribution process without serious harm to the fixed price offering system. We believe that the proposed rule changes relating to swaps and sales to affiliates have been the subject of relatively little adverse comment. Most of the adverse comments on the proposed changes of which we are aware have been directed toward those relating to designated sales.

**Swaps and Sales to Affiliates.** Assuming the proposed rule changes relating to swaps and sales to affiliates are approved substantially as proposed, we believe that this will help prevent an erosion of the fixed price offering system without significant adverse effect on individual or institutional purchases in fixed price offerings. While a tightening of the rule relating to swaps might be preferred by certain firms, we should point out that overly severe restrictions on swaps could adversely affect the market's ability to absorb current volumes of the kinds of securities which are commonly sold in connection with swap transactions and the secondary trading markets for some securities.

If the Commission should disapprove the proposed rule changes relating to swaps and sales to affiliates and conclude either that the NASD's existing rules do not prohibit these practices or that the existing rules violate the Exchange Act, the consequences depend on whether underwriters and selling group members live up to their agreements which require them to offer and sell securities to unaffiliated customers at the stated public offering price until trading restrictions are terminated. Given the fact that managing underwriters are no longer able to detect violations of the syndicate agreements in most cases, the impracticality of pursuing violators in the courts and the pressures to be expected from institutional and other large-volume purchasers, we are concerned that the fixed price offering system could break down in the absence of rules. If this should happen, institutional and other large-volume purchasers could obtain securities at lower prices. However, we believe that this special advantage for a limited number of large-volume purchasers would be far outweighed by the damage to the nation's capital-raising process.

Absent effective price maintenance in connection with securities distributions, we believe that (1) underwriting risk will increase dramatically, (2) the cost to issuers of raising capital through underwritten public offerings will increase, (3) individual investors will be driven out of the market for new securities and (4) the trend to concentration in the securities industry will be accelerated.

(1) Increased Underwriting Risk. Absent a joint effort to sell the securities at the same price to investors, the risk of incurring underwriting losses would increase substantially. Underwriters would be unable to determine at what price they would be able to sell the securities. They would also be more uncertain as to how long it would take to sell the securities, which would increase the risk of intervening economic and market changes adversely affecting their ability to sell the securities.

In such an environment, stabilization would be unlawful under present rules* and, in any event, would be foolhardy and ineffective. If a managing underwriter attempts to stabilize the market price at or near the public offering price while underwriters are selling securities to institutions at a discount from the public offering price, institutions could make a virtually risk-free arbitrage profit by buying the security from an

*Rule 10b-7 prohibits stabilizing in any "offering at the market," which it defines as an offering in which it is contemplated that any offering price set in any calendar day will be increased more than once in such calendar day.*

underwriter at the public offering price less a negotiated discount and selling it back to the syndicate at the public offering price. The syndicate would be forced to lower or pull its bid. At this point the market price of the security would be apt to fall and the ability of the syndicate to sell at the public offering price would be undermined. Except under very unusual circumstances, stabilization at a significant discount from the intended public offering price would be ineffective in facilitating the distribution. Under today's conditions, it is virtually impossible to trace securities and find out which institutional purchasers are selling into the syndicate bid. And, as a practical matter, the institutions probably do not care whether they are detected.*

(2) Increased Cost to Issuers. Increased risk to underwriters can be expected to result in increased cost to issuers. The spread compensates underwriters for underwriting and distributing securities and cushions them against underwriting risks. There is probably no better accepted rule in the investment world than the principle that riskier investments have to offer greater expected rewards. We see this every day in the securities markets where lower quality issues offer investors greater expected returns than higher quality issues. If the risk of underwriting and distributing securities increases, participants in the distribution process will have to be compensated for this higher risk by higher compensation in the form of wider spreads.* Presumably investors will be unwilling to pay for new bonds or equities prices higher than the prices of comparable investments available in the marketplace, for this would give them lower yields or returns than those available in the marketplace. Accordingly, underwriters wishing to minimize and protect against increased underwriting risks can be expected to increase the spread charged to the issuer and/or lower the public offering price to the customer (to reduce underwriting risk by increasing the probability that the securities will all be sold), each of which has the effect of lowering the net proceeds from the offering and increasing the cost to the issuer of raising capital. Higher costs would lead issuers to refrain from making certain capital investments. Increased capital costs could have grave consequences for a country plagued with double-digit inflation, deteriorating productivity and too little investment in plant, equipment, research and development.

Underwriters could take other steps designed to limit their risk exposure. Underwriters might not routinely accept underwriting invitations as they do now but wait to see the reception of the security in the marketplace during the offering period, who the other underwriters are, the final terms, etc. before deciding to participate. Such firms might decline invitations or withdraw tentative acceptances more frequently, thereby spreading the underwriting risk among fewer participants. Underwriters might be unwilling to enter into firm commitment underwritings for issuers regarded as "marginal", either because of their current problems, the nature of their business or the stage of their development. At times an issuer's only source of capital may be a public willing to take substantial risks in return for the chance of unusual reward, **e.g.**, a credit risk in return for a high yield, a lower yield in return for an equity "kicker" or a speculative investment in return for the chance of an extraordinary gain. Thus, the range of issuers with access to the capital markets through firm commitment underwritten public offerings would be reduced.

Another way of reducing risk, of course, is for securities firms to withdraw from underwriting securities completely. It is entirely possible that many smaller securities firms may choose this strategy as a way of preserving their limited capital. The withdrawal of smaller regional firms from underwriting would be particularly harmful to small companies, which are often brought to market by smaller investment bankers.* If the fixed price offering system deteriorates significantly, this would be particularly troublesome for newer, riskier companies. Without the fixed price offering system, the underwriting of securities of these companies would be especially risky. Since there is greater uncertainty about the "right" price for such companies to begin with, the possibility of an unsuccessful distribution would make underwriters extremely conservative in the price offered the issuer. The cost of public capital to such companies might become so prohibitive that the public capital markets are all but closed to newer companies.

Higher costs of raising capital and the closing of our capital markets to newer, riskier companies would be inconsistent with the expressed government concern relating to capital investment and small business. Congress, the executive branch and government agencies, including the SEC, have addressed the question of how to increase capital formation, particularly for smaller businesses. It would be ironic if at this time the Commission disallowed rules which are necessary

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* *The only effective way to stop this practice is to deprive institutions of the economic incentive by effectively requiring them to pay the public offering price for the securities they purchase in a distribution. The proposed rule change would deprive speculators of the opportunity to purchase securities from one underwriter and sell them back to the syndicate, thereby realizing a profit.*

* *Attached as Appendix F are charts showing how spreads, as a percentage of the public offering price, have fluctuated in relationship to changes in perceived risks, as reflected in volatility of related stock price indices.*

* *See* NASD, ***Small Business Financing*** *28 (May 22, 1979).*

to support a system which has enabled issuers to raise capital at relatively low costs and which enables new or marginal companies to raise sorely needed capital.

(3) Impact on Individual Investors. Absent effective price maintenance in connection with securities distributions, individuals might refrain from purchasing securities in the process of distribution. If institutions succeed in purchasing securities at prices significantly below those available to smaller investors, individual investors would undoubtedly see an after-market based on the lower prices at which institutions are purchasing the securities or a depressed after-market resulting from price-cutting as underwriters and dealers compete with each other to get rid of their securities. In either case, the result is likely to be individual investor disenchantment with buying securities in public offerings. The advantage of buying in a public offering (**i.e.,** the payment of the commission by the issuer and, under ideal situations, a slight rise in the after-market) would be lost and the individual investor would in all likelihood wait and buy in the after-market if at all. The overall effect would appear to be to drive individual investors out of the market for public offerings and accelerate the trend toward institutionalization of securities holdings without any advantage to issuers or the capital-raising process.

(4) Concentration. Absent effective price maintenance in connection with securities distributions, underwriters with substantial distribution capability could attempt to reduce risk through the exercise of greater control over the distribution process by reducing the size of underwriting groups, increasing the portion of the total issue being underwritten by and released for sale to the managing underwriters and increasing the amount of securities reserved for the "pot". Firms without distribution capability might find it necessary to increase their retail and institutional distribution capability through the acquisition of other firms in order to be in a position to take similar steps to reduce their underwriting risk. As was said before, increased risk, underwriting losses and declining profitability could lead some firms to drop out of underwriting altogether. Of course, at a certain point, as the number of underwriters either in general or in an underwriting syndicate declines, the risk to each underwriter increases and an underwriter could find that it could not participate in as many or as large underwritings as at present.

Designated Sales. The Commission solicits comments on the impact of adoption of the proposed rule changes relating to designated sales on various classes of persons and the fixed price offering system in general.

First, we believe that approval of the proposed rule changes relating to designated sales will have little effect on institutions' purchases of securities in fixed price offerings. Presumably they have funds to invest and they have an obligation to invest them in the most attractive securities at the most attractive prices. To the extent that new issues represent attractive investment opportunities in comparison with other available securities it is reasonable to assume that institutions will be buyers. It is extremely rare for an institution to purchase securities solely for the purpose of rewarding broker-dealers. Even if an institution did so, this would not contribute to the real demand for the security. In all likelihood, an institution buying for that reason would quickly sell the security, with a net adverse impact on the securities distribution process. Accordingly, even if one assumes that the proposed rule change would adversely affect a small amount of securities purchases, it is doubtful that this would adversely affect the fixed price offering process.

The Commission's questions relating to participation by broker-dealers in underwriting syndicates and selling groups seem to assume that there are a significant number of small broker-dealers who are excluded from underwriting syndicates or selling groups, or whose participation therein is arbitrarily limited, by managing underwriters. We believe that this assumption is not valid and that any broker-dealer with demonstrated distribution capability and an ability and willingness to assume underwriting risk is afforded ample opportunity to participate in underwriting syndicates and selling groups.

As a practical matter, there is very little profit left in the underwriting portion of the spread. In recent years, the selling concession, which is allowed to the broker-dealers which actually sell the securities, has come to represent an increasing percentage of the total spread. See Appendix E. After payment of the selling concession and the management fee, the remainder is usually barely enough to cover the expenses of the underwriting syndicate, and, if there are losses on stabilization or short-covering, underwriters may be required to send the managing underwriters a check. Accordingly, as an economic matter, the real question is to whom securities are allocated for actual sale.

In a particular issue, a managing underwriter allocates securities to those broker-dealers which have demonstrated that they can place them with investors. It is responsive to any desires expressed by the issuer, including a desire for a retail distribution or a broad geographical distribution. A managing underwriter's judgment as to the ability of a broker-dealer to distribute the particular type of security involved, the credibility of a broker-dealer's claims of indications-of-interest and whether the broker-dealer's prospective customers are likely to be long-term investors or speculators seeking a quick profit will all affect the allocation. Over time securities are allocated by managing underwriters to those broker-dealers which have demonstrated a capability to place securities with investors in good times and in bad and in hard-to-sell as well as easy-to-sell offerings. If a managing

underwriter did not do this, the competition is such that it would probably not continue to be a managing underwriter for long.

## Conclusion

Each year the United States securities industry raises billions of dollars of capital for corporate and municipal issuers through public offerings.* In the overwhelming majority of cases broker-dealers do this by banding together in discrete, **ad hoc** syndicates to combine their underwriting capital, spread the risk of loss from unsuccessful issues and increase their distribution capability. They agree with each other that for a limited period they will all attempt to market the securities on the same terms. This assures them that during this limited period they will not undermine their joint efforts to launch into the marketplace a new securities issue or a substantial quantity of a security which is already trading in the marketplace. During this limited period the managing underwriter may, for the syndicate's account and in accordance with the Commission's rules, stabilize the market to facilitate the distribution.

We believe that limited price maintenance by underwriting syndicates during the distribution period has been absolutely essential to enable the securities industry to raise for corporate and municipal issuers the huge amounts of capital which it has raised during the better part of this century at the lowest underwriting cost in the world. We believe that the use of limited price maintenance by underwriting syndicates is the central pillar of the most effective and most efficient capital-raising process in the world.

Limited price maintenance by syndicates in connection with fixed price offerings of corporate securities is threatened by certain abuses. If not effectively prevented, such abuses could lead to a serious erosion of the fixed price offering system and serious consequences to the nation's capital-raising process. The NASD's proposed rule changes are designed to prevent that erosion. Accordingly, we urge the Commission to approve the proposed rule changes or to work with the NASD to remedy any deficiencies which the Commission sees in the proposed rule changes. We are prepared to assist the NASD and the Commission in whatever way we can to achieve rules which effectively support the fixed price offering system and contribute to the preservation of this nation's system of raising capital through underwritten public offerings.

July 31, 1979.

SECURITIES INDUSTRY ASSOCIATION

** For information as the amount of capital raised in each of the last five years, see Appendix G.*

## APPENDIX A

### Corporate Underwritings for Selected Years, 1948–1978

| Year | Capital Raised (millions) |
|---|---|
| 1948 | $ 3,711 |
| 1950 | 3,762 |
| 1955 | 6,154 |
| 1959 | 6,727 |
| 1967 | 19,883 |
| 1974 | 31,627 |
| 1975 | 46,828 |
| 1976 | 42,353 |
| 1977 | 36,693 |
| 1978 | 31,150 |

**Source:** Investment Dealers' Digest, Corporate Financing Directory

# APPENDIX B

**Chart Depicting Underwriting Firms in a Ford Motor Company Stock Offering on January 18, 1956 which Have Merged or Are No Longer in Business**

*This is not an offering of these Shares for sale, or an offer to buy, or a solicitation of an offer to buy, any of such Shares. The offering is made only by the Prospectus.*

# 10,200,000 Shares

# Ford Motor Company

## Common Stock

**($5 Par Value)**

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**Price $64.50 per share**

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***Copies of the Prospectus may be obtained only from such of the undersigned as are registered or licensed dealers or brokers in securities in this State.***

Blyth & Co., Inc.
The First Boston Corporation
Goldman, Sachs & Co.
Kuhn, Loeb & Co.
Lehman Brothers
Merrill Lynch, Pierce, Fenner & Beane
White, Weld & Co.
Eastman, Dillon & Co.
Harriman Ripley & Co. Incorporated
Kidder, Peabody & Co.
Lazard Frères & Co.
Smith, Barney & Co.
Union Securities Corporation
Dean Witter & Co.
American Securities Corporation
Bear, Stearns & Co.
Drexel & Co.
Hemphill, Noyes & Co.
Hornblower & Weeks
Carl M. Loeb, Rhoades & Co.
F. S. Moseley & Co.
Paine, Webber, Jackson & Curtis
Wertheim & Co.
Allen & Company
Clark, Dodge & Co.
Dominick & Dominick
Hallgarten & Co.
W. E. Hutton & Co.
Reynolds & Co.
Bache & Co.
A. G. Becker & Co. Incorporated
E. F. Hutton & Company
Alex. Brown & Sons
F. Eberstadt & Co.
First of Michigan Corporation
Hayden, Stone & Co.
L. F. Rothschild & Co.
Salomon Bros. & Hutzler
Shields & Company
Spencer Trask & Co.
Tucker, Anthony & Co.
G. H. Walker & Co.
Watling, Lerchen & Co.
Wood, Struthers & Co.
Baker, Weeks & Co.
Model, Roland & Stone
Coffin & Burr Incorporated
R. S. Dickson & Company Incorporated
Estabrook & Co.
Goodbody & Co.
Granbery, Marache & Co.
Mitchell, Hutchins & Co.
Schwabacher & Co.
Shearson, Hammill & Co.
A. E. Ames & Co. Incorporated
The Dominion Securities Corporation
First California Company Incorporated
McLeod, Young, Weir, Incorporated
Riter & Co.
Shuman, Agnew & Co.
William R. Staats & Co.
Swiss American Corporation
Van Alstyne, Noel & Co.
Wood, Gundy & Co., Inc.
Abbott, Proctor & Paine
Robert W. Baird & Co., Incorporated
J. Barth & Co.
Bateman, Eichler & Co.
William Blair & Company
Boettcher and Company
Bosworth, Sullivan & Company, Inc.
J. C. Bradford & Co.
Courts & Co.
Crowell, Weedon & Co.
Elworthy & Co.
A. M. Kidder & Co.
Laird, Bissell & Meeds
Laird & Company
Lester, Ryons & Co.
Irving Lundborg & Co.
Manley, Bennett & Company
McDonald & Company
The Milwaukee Company
Mitchum, Jones & Templeton
Newhard, Cook & Co.
The Ohio Company
Piper, Jaffray & Hopwood
Reinholdt & Gardner
The Robinson-Humphrey Company, Inc.
Wm. C. Roney & Co.
Stroud & Company Incorporated
Sutro & Co.
Auchincloss, Parker & Redpath
Bacon, Whipple & Co.
Ball, Burge & Kraus
Blunt Ellis & Simmons
Brush, Slocumb & Co. Inc.
Richard J. Buck & Co.
Burnham and Company
J. M. Dain & Company Incorporated
Davis, Skaggs & Co.
First Southwest Company
Folger, Nolan-W. B. Hibbs & Co., Inc.
Fulton, Reid & Co.
Hayden, Miller & Co.
H. Hentz & Co.
Hill Richards & Co.
J. J. B. Hilliard & Son
J. A. Hogle & Co.
The Illinois Company Incorporated
Johnston, Lemon & Co.
Kalman & Company, Inc.
McCormick & Co.
Merrill, Turben & Co., Inc.
Moore, Leonard & Lynch
Putnam & Co.
Rauscher, Pierce & Co., Inc.
Scott & Stringfellow
I. M. Simon & Co.
Singer, Deane & Scribner
Stein Bros. & Boyce
Stern Brothers & Co.
Wagenseller & Durst, Inc.
Adams & Peck
Almstedt Brothers
Baker, Watts & Co.
George D. B. Bonbright & Co.
Butcher & Sherrerd
Carolina Securities Corporation
Julien Collins & Company
Cooley & Company
Cruttenden & Co.
R. L. Day & Co.
Dewar, Robertson & Pancoast
Dittmar & Company
Doolittle & Co.
A. G. Edwards & Sons
Fahey, Clark & Co.
Ferris & Company
Foster & Marshall
Gerstley, Sunstein & Co.
Howard, Weil, Labouisse, Friedrichs and Company
Johnson, Lane, Space & Co., Inc.
Edward D. Jones & Co.
Jones, Kreeger & Hewitt
Kay, Richards & Company
John C. Legg & Company
Loewi & Co.
Mason Brothers
Mason-Hagan, Inc.
A. E. Masten & Company
Nesbitt, Thomson and Company, Inc.
W. H. Newbold's Son & Co.
Newburger & Co.
Peters, Writer & Christensen, Inc.
Phelps, Fenn & Co.
W. C. Pitfield & Co. Inc.
Prescott, Shepard & Co., Inc.
Rotan, Mosle & Co.
M. A. Schapiro & Co., Inc.
Chas. W. Scranton & Co.
Silberberg & Co.
Smith, Moore & Co.
Stern, Frank, Meyer & Fox
Stifel, Nicolaus & Company Incorporated
Stillman, Maynard & Co.
Stix & Co.
Underwood, Neuhaus & Co. Incorporated
Weeden & Co. Incorporated
Yarnall, Biddle & Co.
Arnhold and S. Bleichroeder, Inc.
Burn Bros. & Denton, Inc.
Richard W. Clarke Corporation
Shelby Cullom Davis & Co.
Dreyfus & Co.
Fahnestock & Co.
Green, Ellis & Anderson
Halle & Stieglitz
Harris & Partners Limited Inc.
Ingalls & Snyder
Mills, Spence & Co. Inc.
Parrish & Co.
Carl H. Pforzheimer & Co.
C. B. Richard & Co.
Stern, Lauer & Co.
Stetson Securities Corporation
Bell, Gouinlock & Company Incorporated
W. E. Burnet & Co.
Coggeshall & Hicks
Eisele & King, Libaire, Stout & Co.
S. D. Fuller & Co.
Greenshields & Co (N.Y.) Inc
Josephthal & Co.
Moore & Schley
New York Hanseatic Corporation
Pyne, Kendall & Hollister
H. N. Whitney, Goadby & Co.
Bruns, Nordeman & Co.
Byrd Brothers
Granger & Company
Grimm & Co.
Gruss & Co.
Herzfeld & Stern
Kormendi & Co., Inc.
B. W. Pizzini & Co., Inc.
Wm. E. Pollock & Co., Inc.
Rand & Co.
A. L. Stamm & Co.
C. E. Unterberg, Towbin Co.
Abraham & Co.
Auerbach, Pollak & Richardson
P. W. Brooks & Co. Incorporated
Ernst & Co.
Glidden, Morris & Co.
Hardy & Co.
Hecht & Co.
Hoppin Bros. & Co.
Edward A. Purcell & Co.
Rosenthal & Co.
T. L. Watson & Co.
January 18, 1956
Merged or Acquired
Discontinued Business

## APPENDIX C

### Size of Corporate Finance Staffs

| Firm | 1965 | January 1978 |
|---|---|---|
| Bache Halsey Stuart | 24 | 42 |
| Bear Stearns | 10 | 22 |
| Blyth Eastman Dillon | 35 | 122 |
| Dillon Read | 34 | 72 |
| E.F. Hutton | 8 | 90 |
| First Boston | 25 | 182 |
| Goldman Sachs | 42 | 156 |
| Kidder Peabody | 41 | 133 |
| Merrill Lynch | 19 | 240 |
| Morgan Stanley | 33 | 135 |
| Paine Webber | 12 | 79 |
| Salomon Brothers | 10 | 145 |
| Smith Barney | 36 | 127 |

**Source:** Hayes, "The Transformation of Investment Banking," *Harvard Bus. Rev.* 153, 160 (Jan.-Feb. 1979).

APPENDIX D

## Ranking of Leading Syndicate Managers in Dollar Volume of All Corporate Issues — Proportionate Credit

| Firm | 1947-1949[a] | 1961-1963[a] | 1975[b] | 1976[b] | 1977[b] |
|---|---|---|---|---|---|
| Morgan Stanley | 2 | 1 | 1 | 1 | 1 |
| Merrill Lynch | 16 | 6 | 2 | 2 | 2 |
| Salomon Brothers | 7 | 11 | 5 | 3 | 3 |
| Goldman Sachs | 17 | 16 | 4 | 5 | 4 |
| First Boston | 3 | 3 | 3 | 4 | 5 |
| Blyth Eastman Dillon | 4[c], 20[d] 14[e] | 4[c], 8[d] | 7 | 6 | 6 |
| Lehman Brothers | 5 | 5 | 6 | 9 | 7 |
| Dean Witter | | 17 | 12 | 11 | 8 |
| Kidder Peabody | 13 | 10 | 9 | 8 | 9 |
| White Weld | 9 | 7 | 14 | 7 | 10 |
| Bache Halsey Stuart | 1[f] | 2[f] | 11[f] | 14 | 11 |
| Smith Barney Harris Upham | 10[g] | 12[g] | 8[g] | 10 | 12 |
| E.F. Hutton | | | 17 | 15 | 13 |
| Paine Webber | 25 | 18 | 15 | 16 | 14 |
| Kuhn Loeb | 8 | 14 | 10 | 12 | 15 |
| Dillon, Read | 12 | 9 | 13 | 13 | 16 |
| Drexel Burnham | | | 18 | 19 | 17 |
| Loeb Rhoades | | | 20 | 20 | 18 |
| Lazard Freres | 24 | 21 | 16 | 18 | 19 |
| Warburg Paribas Becker | | | 21 | 17 | 20 |
| McLeod Young Weir | | | | | 21 |
| Wood Gundy | | | 19 | 23 | 22 |
| Hornblower & Weeks | | | 26 | 24 | 23 |
| A.G. Edwards & Sons | | | | | 24 |
| Bear Stearns | | | | | 25 |

## Ranking of Leading Syndicate Managers in Dollar Volume of All Corporate Issues—Full Credit for Each Co-manager

| Firm | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|
| Salomon Brothers | 3 | 2 | 2 | 1 |
| Merrill Lynch White Weld | 1[h] | 1[h] | 1[h] | 2 |
| Morgan Stanley | 4 | 3 | 3 | 3 |
| Goldman Sachs | 5 | 5 | 5 | 4 |
| First Boston | 2 | 4 | 4 | 5 |
| Dean Witter Reynolds | 11[j], 24[j] | 10[j], 22[j] | 8[j], 22[j] | 6 |
| Blyth Eastman Dillon | 6 | 6 | 6 | 7 |
| Lehman Brothers Kuhn Loeb | 7[k], 13[j] | 13[k], 12[j] | 10[k], 15[j] | 8 |
| Kidder Peabody | 9 | 9 | 9 | 9 |
| E.F. Hutton | 15 | 15 | 13 | 10 |
| Smith Barney, Harris Upham | 10[g] | 11 | 11 | 11 |
| Paine Webber | 12 | 16 | 14 | 12 |
| Bache Halsey Stuart Shields | 8[i] | 7 | 7 | 13 |
| Drexel Burnham Lambert | 16 | 18 | 16 | 14 |
| Dillon Read | 17 | 14 | 18 | 15 |
| Wood Gundy | | | | 16 |
| A.E. Ames | | | | 17 |
| Loeb Rhoades Hornblower | 19[m], 22[n] | 17[m], 23[n] | 17[m], 19[m] | 18 |
| White Weld | 14 | 8 | 12 | 19[g] |
| Wertheim | 25 | 25 | 20 | 20 |
| Bear Stearns | | | 25 | 21 |
| Donaldson, Lufkin & Jenrette | | | | 22 |
| Warburg Paribas Becker | 23 | 20 | 21 | 23 |
| Lazard Freres | 18 | 19 | 23 | 24 |
| Rothschild, Unterberg, Towbin | | | | 25 |

## Ranking of Leading Syndicate Managers in Dollar Volume of All Corporate Issues—Full Credit to the Lead Manager Only

| Firm | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|
| Morgan Stanley | 1 | 1 | 1 | 1 |
| Salomon Brothers | 4 | 4 | 2 | 2 |
| Merrill Lynch White Weld | 3[h] | 3[h] | 3[h] | 3 |
| Goldman Sachs | 5 | 6 | 6 | 4 |
| First Boston | 2 | 2 | 4 | 5 |
| Blyth Eastman Dillon | 6 | 5 | 5 | 6 |
| Lehman Brothers Kuhn Loeb | 7[k], 9[l] | 8[k], 7[l] | 9[k], 8[l] | 7 |
| Kidder Peabody | 8 | 10 | 7 | 8 |
| Smith Barney, Harris Upham | 10[g] | 11 | 16 | 9 |
| Bache Halsey Stuart Shields | 13[f] | 16 | 14 | 10 |
| Drexel Burnham Lambert | 18 | 18 | 15 | 11 |
| Dean Witter Reynolds | 15[i] | 14[j] | 13[i] | 12 |
| Dillon Read | 11 | 12 | 10 | 13 |
| Paine Webber | 16 | 15 | 18 | 14 |
| White Weld | 12 | 9 | 11 | 15[o] |
| Loeb Rhoades Hornblower | 21[m] | 19[m] | 19[m] | 16 |
| E.F. Hutton | 17 | 17 | 12 | 17 |
| Bear Stearns | | | 21 | 18 |
| Rothschild, Unterberg, Towbin | | | 24 | 19 |
| Warburg Paribas Becker | 19 | 20 | 22 | 20 |
| Oppenheimer | | | | 21 |
| Wertheim | | | | 22 |
| Lazard Freres | 14 | 13 | 17 | 23 |
| Allen | | | | 24 |
| Ohio Co. | | | | 25 |

**FOOTNOTES**

**(a)** Source: Friend, Longstreet, Mendelson, Miller and Hess, *Investment Banking and the New Issues Market*, World Publishing Company, New York, 1967, Tables 2.29 and 2.31, pp. 159-161.
**(b)** Source: *Investment Dealers' Digest*, March 1978, March 1977, March 1976.
**(c)** Blyth & Co.
**(d)** Eastman Dillon, Union Securities & Co.
**(e)** Union Securities Corp. (prior to merger to Eastman Dillon)
**(f)** Halsey Stuart
**(g)** Smith Barney
**(h)** Merrill Lynch, Pierce, Fenner & Smith
**(i)** Dean Witter
**(j)** Reynolds Securities
**(k)** Lehman Brothers
**(l)** Kuhn Loeb
**(m)** Loeb Rhoades
**(n)** Hornblower & Weeks
**(o)** Acquired by Merrill Lynch April 1978.

## APPENDIX E

### Negotiated Offerings of Seasoned Common Stock of Industrial Companies, 1971-1978

| | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|---|---|---|---|
| Issues under $10 million | | | | | | | | |
| Gross Spread (%) | 7.0 | 7.3 | 7.1 | 7.1 | 7.1 | 6.9 | 7.3 | 7.2 |
| Selling Concession as a percentage of Gross Spread | 54.2 | 53.7 | 55.3 | 59.2 | 56.9 | 59.9 | 58.6 | 57.7 |
| Issues $10 to $25 million | | | | | | | | |
| Gross Spread (%) | 5.4 | 5.3 | 5.3 | 5.4 | 5.5 | 5.3 | 5.8 | 5.6 |
| Selling Concession as a percentage of Gross Spread | 55.4 | 54.7 | 57.4 | 56.8 | 59.4 | 58.6 | 57.5 | 59.5 |
| Issues over $25 million | | | | | | | | |
| Gross Spread (%) | 4.7 | 4.4 | 3.7 | 4.2 | 4.0 | 3.6 | 4.0 | 4.0 |
| Selling Concession as a percentage of Gross Spread | 53.9 | 56.2 | 56.3 | 59.7 | 58.2 | 63.2 | 58.4 | 56.9 |

### Negotiated Offerings of Utility Common Stock, 1971-1978

| | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|---|---|---|---|
| Issues under $20 million | | | | | | | | |
| Gross Spread (%) | 4.4 | 3.5 | 3.4 | 6.2 | 5.3 | 3.3 | 3.6 | 3.5 |
| Selling Concession as a percentage of Gross Spread | 56.9 | 60.9 | 66.2 | 68.6 | 65.7 | 69.8 | 65.9 | 67.9 |
| Issues $20 million and greater | | | | | | | | |
| Gross Spread (%) | 3.4 | 3.2 | 4.1 | 6.1 | 4.7 | 3.9 | 2.9 | 3.0 |
| Selling Concession as a percentage of Gross Spread | 61.9 | 62.8 | 65.2 | 67.7 | 66.8 | 66.0 | 69.7 | 71.1 |

Negotiated Offerings of Telephone Common Stock, 1971-1978

| | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|---|---|---|---|
| Issues under $20 million | | | | | | | | |
| Gross Spread (%) | 6.5 | 4.7 | 5.4 | 5.6 | 4.8 | 3.4 | 4.0 | 5.4 |
| Selling Concession as a percentage of Gross Spread | 56.5 | 60.2 | 60.6 | 62.3 | 67.6 | 62.3 | 70.7 | 60.5 |
| Issues $20 million and greater | | | | | | | | |
| Gross Spread (%) | 3.5 | * | * | 6.2 | 4.0 | 3.4 | 3.3 | 3.8 |
| Selling Concession as a percentage of Gross Spread | 59.2 | — | — | 64.2 | 67.9 | 62.2 | 62.9 | 66.7 |

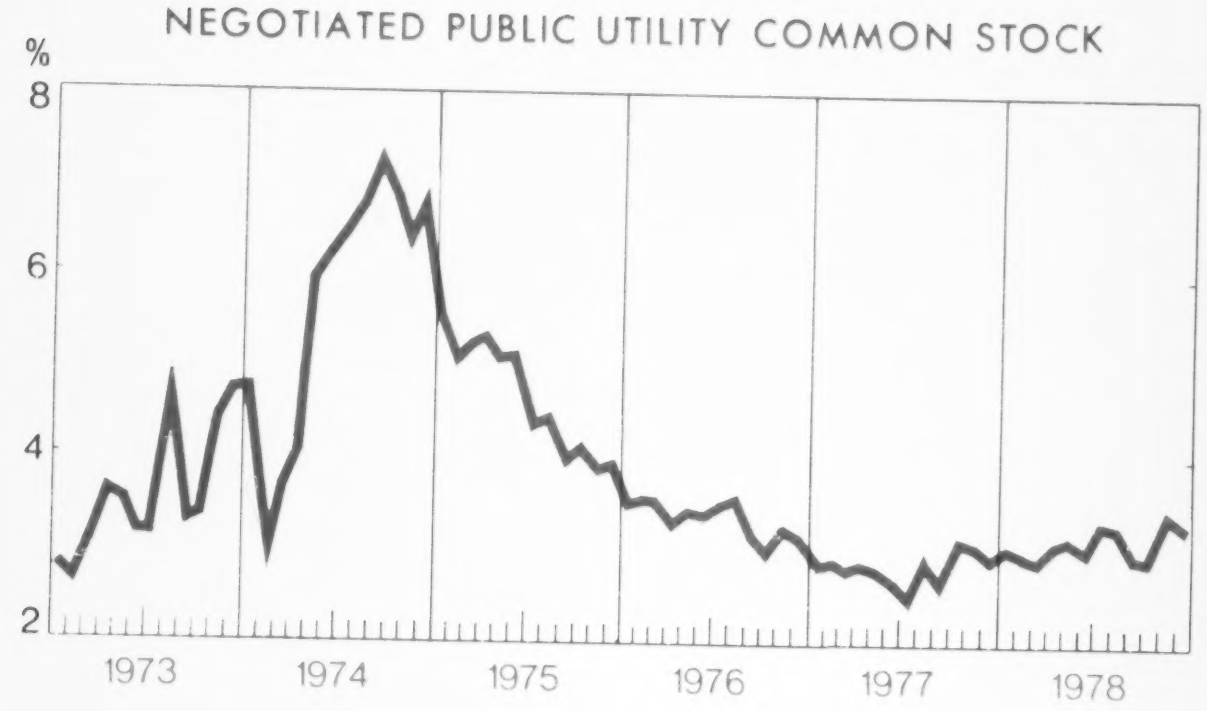
*No issues of this size during the year.

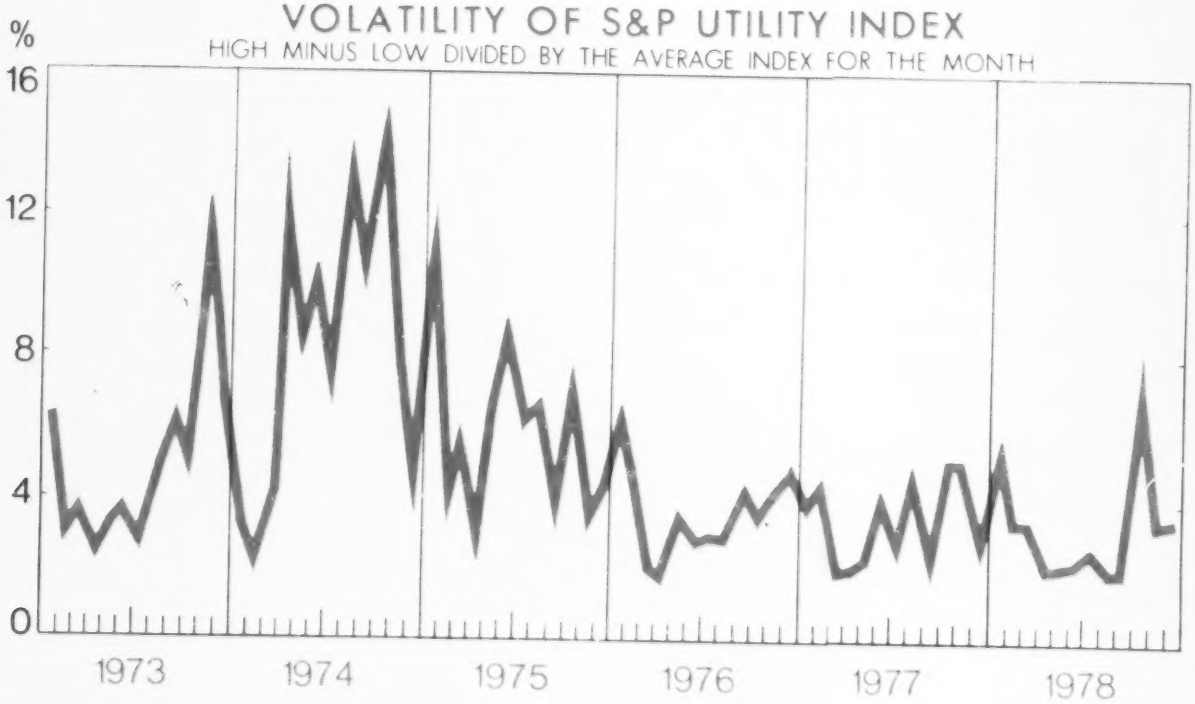
Initial Public Offerings (Negotiated) of Common Stock of Industrial Companies, 1971-1978

| | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|---|---|---|---|
| Gross Spread (%) | 6.8 | * | 8.3 | 8.9 | 7.4 | 7.5 | 7.8 | 7.2 |
| Selling Concession as a percentage of Gross Spread | 54.6 | — | 50.8 | 54.8 | 57.8 | 57.2 | 56.1 | 54.9 |

*No issues of this size during the year.

# Average Underwriting Gross Spreads



# Average Underwriting Gross Spreads

APPENDIX G

## Capital Raised through Public Offerings

| | 1974 | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|---|
| | (billions of dollars) | | | | |
| Corporate: | | | | | |
| Debt | $26.8 | $31.2 | $25.3 | $21.9 | $18.6 |
| Equity* | 4.8 | 11.1 | 11.2 | 9.2 | 8.1 |
| **Total Corporate** | **31.6** | **42.3** | **36.5** | **31.1** | **26.7** |
| Municipal: | | | | | |
| Revenue Bonds | 10.2 | 14.6 | 17.3 | 28.7 | 28.9 |
| General Obligation | 13.6 | 16.0 | 18.0 | 18.0 | 17.0 |
| **Total Municipals** | **23.8** | **30.6** | **35.3** | **46.7** | **45.9** |
| Foreign Issuers: | **1.3** | **4.5** | **5.8** | **5.6** | **4.4** |
| Total | **$56.7** | **$77.4** | **$77.6** | **$83.4** | **$77.1** |

*Includes convertible debt, preferred stock and common stock.